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UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

IN RE: DONALD TRUMP CASINO SECURITIES LITIGATIONS

CIVIL ACTION
MDL DOCKET NO. 864

TAJ MAHAL ACTIONS

90mc919

UNITED STATES COURTHOUSE
401 MARKET STREET
CAMDEN, NEW JERSEY 08181
MAY 1, 1992

B E F O R E: THE HONORABLE JOHN F. GERRY, CHIEF JUDGE
DISTRICT OF NEW JERSEY

A P P E A R A N C E S:

GREENFIELD AND CHIMICLES
BY: MARK C. RIFKIN, ESQUIRE
ATTORNEYS FOR PLAINTIFFS

WECHSLER, SKIRNICK, HARWOOD, HALEBIAN & FIFFER
BY: JOEL C. FEFFER, ESQUIRE
ATTORNEYS FOR THE PLAINTIFFS

BERGER AND MONTAGHUE
BY: TODD S. COLLINS, ESQUIRE
ATTORNEYS FOR THE PLAINTIFFS

ZWERLING, SCHACTER AND ZWERLING
BY: ROBERT S. SCHACTER, ESQUIRE
ATTORNEYS FOR PLAINTIFFS

APPEARANCES CONTINUED:

CLAPP AND EISENBERG
BY: JOHN J. BARRY, ESQUIRE
ATTORNEYS FOR THE TRUMP DEFENDANTS

WILKIE, FARR AND GALLAGHER
BY: RICHARD L. POSEN, ESQUIRE
ATTORNEYS FOR DEFENDANT TAJ MAHAL

SHEARMAN & STERLING
BY: STUART J. BASKIN, ESQUIRE
ATTORNEYS FOR DEFENDANT MERRILL LYNCH

THEODORE M. FORMAROLI, C.S.R.
OFFICIAL U. S. REPORTER

THE COURT: Okay, everybody, would you enter your appearances, please.

MR. POSEN: Richard Posen of Wilkie, Farr and Gallagher.

MR. BARRY: John J. Barry, Clapp and Eisenberg, for the Trump defendants.

MR. BASKIN: Stuart Baskin, Shearman and Sterling, for Merrill Lynch.

MR. FEFFER: Joel C. Feffer of Wechsler Skirnick, plaintiffs.

MR. COLLINS: Todd Collins, Berger and Montaghue, for plaintiffs.

MR. SCHACTER: Robert Schacter, Zwerling, Schacter and Zwerling.

MR. RIFKIN: Mark Rifkin, Greenfield and Chimicles, for the plaintiffs.

THE COURT: Okay. Everybody onboard? Good. All right, the court has carefully studied your submissions, we're familiar with them and generally with your arguments and have passing familiarity with the citations to which you have referred us. So keep that in mind, if you will, when you argue, okay?

We'll hear from the moving party.

MR. POSEN: May it please the court, I am Richard Posen, I represent, together with John Barry, the Trump

defendants in these consolidated cases. I hope to be brief, your Honor, and to be mindful of your opening comments on your familiarity with the record.

As your Honor obviously knows --

THE COURT: Oh, excuse me. I'm sorry. I invited you to go ahead, Mr. Posen, and I forgot that for your guidance and everybody else's I would like to limit the argument today, this afternoon, to the "bespeaks caution" line of argument and the related sub-issues, of course, that that suggests. To the extent that you feel that you can, try to focus on that area.

I'll be asking questions from time to time and I think most of the questions will in turn relate to that area. To the extent they don't, I wouldn't blame you for being perplexed, but don't share your perplexity with me.

You may proceed, Mr. Posen. Go ahead.

MR. POSEN: Thank you, your Honor. As I presume then, as your initial comments make absolutely clear to me, you are very focused on the issue before the court today, notwithstanding the excessive amount of paper we've used to get it to this ripened stage, and that is whether the prospectus for the sale of the 675 million dollars of Taj Mahal bonds fairly and accurately described the proposed investment to a reasonable investor. More specifically, I submit, the whole case is about whether the risk of this

investment was adequately disclosed. And I would submit, your Honor, in perhaps exaggerated boldness, that even the "bespeak caution" line of cases which we have argued forcefully are dispositive are not necessary for the court to dismiss this complaint with prejudice. The text of the prospectus itself is a complete defense.

I will venture unfairly out of the record for a minute by noting that one of my star colleagues, Mr. Hiller, who sits behind me and is the author of this prospectus, has a Princeton education. They know the English language, they know that words even in these troubled times still have meaning. And the answer to this case, and the highly debated sentence to which I will return in a minute, is that the words of this prospectus make it absolutely clear what the risks were and the alleged defects of the prospectus are answered by the text, by the very words of the document itself.

THE COURT: And reasonable minds could not so differ?

MR. POSEN: And reasonable minds could not so differ I think even vaguely, or irrational ones couldn't.

THE COURT: Even, even as a result of abiding by the rule that we must draw those inferences from facts asserted in the complaint most favorable to the non-moving party?

MR. POSEN: Absolutely, your Honor. That is a necessary requirement of the rule and happily conceded by me in this setting. This is, this document, Mr. Hiller's perfect prospectus we call it, it is literally a paradigm of complete disclosure. It's long and it's boring, but it is exactly what the structure of our securities laws call for in today's world.

As your Honor's alluded to, the Courts of Appeals in rapid succession, at least five of them have now adopted the what we refer to by shorthand as the bespeaks caution doctrine and I like to think of that doctrine as standing for the proposition that plaintiffs can to longer assert a complaint in which the sole basis is a dramatic decline in market value and whose sole legal logic is fraud by hindsight. Those kind of cases simply no longer state a claim in the First, Second, Sixth, Eighth and Ninth Circuits and we believe in short order, or certainly hope, in the District of New Jersey as well.

THE COURT: Let me ask you a question. This is in reference to the Korean Airlines admonitions that courts in positions such as this in this case should give close consideration to the out-of-circuit precedent, in this instance the precedent from the transferor, in cases such as this, the multi district situation, where we, the transferee jurisdiction, should give "close consideration"

to the appropriate precedents of the Second Circuit in this instance, transferor.

What does that mean in this case and how does that translate for our purposes into Second versus Third Circuit precedent?

MR. POSEN: I think, your Honor, it means that as a matter of multi district law you ought to pay close attention to the Second Circuit's holdings in the Luce case and in the more recent Oppenheimer decision; that the Third Circuit, notwithstanding arguments to the contrary by the plaintiffs in their answering brief, have not addressed -- the Third Circuit has not addressed the bespeak caution doctrine either directly and certainly not implicitly in the Herskowitz case that they rely on to that point.

In sum, I think you have a blank slate on "bespeaks caution" itself in the Third Circuit and you are well instructed by the law in the Second and ought to adopt it here. I hope I've answered you on that point.

THE COURT: I think you have. Let me carry on with some more questions, if I may.

What's the legal interaction between the bespeaks caution doctrine and the principle that misrepresentations are normally actionable and that statements made without a reasonable basis are deemed untrue? What is the interaction of these two principles of doctrines in this

case and which do we consider first?

MR. POSEN: I have to admit I hadn't considered the order in which they're considered.

THE COURT: All right.

MR. POSEN: But, quite plainly, there is a tension between those doctrines, as the court has enunciated.

THE COURT: The court may be required to treat with the order in which they are considered because the outcome may be considerably different, or not, depending on the order in which they are considered.

But setting the order aside, setting the order aside, what are the interactions of these two doctrines, the latter one of which we're customarily familiar, and you would have us familiarize ourselves in the Third Circuit now with the bespeaks caution doctrine? How do they interact in this case?

MR. POSEN: I think the interaction is different in different cases. But in a case where the text provides the first guidance, I would apply the bespeaks caution doctrine in the first instance as well. Reserving, to be sure, for the court the question whether it is permissible nonetheless to be fraudulent in an utterance in a document that might mislead a reasonable investor. And I would argue that the application fairly made of the bespeaks

caution doctrine can answer in a dispositive way the question of the second doctrine, if the court could conclude, and I think it's fair to do that in this case, that the cautionary language in this prospectus was so complete, so repetitive, so obvious and so well designed to guard the alleged fraudulent statement.

THE COURT: Then it would obviate the findings necessary to apply the other doctrine, the second doctrine?

MR. POSEN: Exactly. Otherwise, otherwise, and maybe I can tie your question into what I was going to turn to next in my argument --

THE COURT: It would be decent of me to permit you to do so. Go ahead.

MR. POSEN: Otherwise, what is poor brother Hiller back at Wilkie Farr in 1988 going to write? I, in preparing the argument, I really did try to figure out why I have begun to be bothered in the arguments that we have made more informally on this subject both before you and Judge Simandle by the almost invective-like and inflated language of fraud that the plaintiffs used to talk about a document that is so straightforward in its enunciation of what this investment is about. And it occurred to me in considering my annoyance, since I've been doing this stuff for some years now, why was I getting so bothered? And I

think I was bothered because I'm here today defending the lawyering skills of my partner. And I think I'm defending something more than that, your Honor, we're talking about -- and given today's news, I don't mean to presume on issues of social greatness or magnitude of the kinds of things that are happening in the public, but we are talking about an important part of how the business world, an important part of American society, governs itself. What are the lawyers who live in the ''34 act and ''33 act world and what are the investment bankers and what are people who are worried about capital formation going to do if they're going to raise money for a project such as this one? And I think in a minute I can describe the dilemma that I think people face in --

THE COURT: Yes, excuse me, go ahead. This is an interesting argument to me because my next question is going to be right, I think, down the barrel. Is this a policy -- that is the bespeaks caution policy -- is this a policy that we should and should want to follow in this circuit? And doesn't its application effectively nullify some of the public policies that undergird the securities laws protections? Do you see any problem --

MR. POSEN: Absolutely not.

THE COURT: -- of any public policy, any inconsistency or injury or potential undermining of the

regulatory practices and theories in the securities field?

MR. POSEN: Absolutely not, your Honor. I try to avoid --

THE COURT: You started to talk about that.

MR. POSEN: I try to avoid 12(b)(6) motions that take on a statutory scheme that's been in existence for 50 years. I dread those kinds of arguments and, indeed, my argument and the one I was trying to -- that I was going to talk about in relation to good old Hiller back in New York is is that there must be a way for lawyers and bankers and businessmen accurately to describe the business that they are about to undertake and to raise money for debt or to raise money for equity or to do other financial transactions that involve prospectuses, proxy statements or the other regulated, regulatory documents that are circulated to the public under the guidelines and very, very complex regulatory scheme that the '33 and '34 acts encompass.

And I think, your Honor, to respond very directly to your question, that the bespeaks caution doctrine is an endorsement of the fundamental concept that we govern ourselves by in this world, which is disclosure, not judgment, not business judgment. Not should you buy the Taj bond, but if you buy the Taj bond, this is the good news, and this is the bad news; this is what you need to

know to make a reasonable business judgment.

I think not merely, not merely -- the late Justice Douglass when he was an early SEC commissioner, different than someone from a very different part of the political spectrum, from the commissioners appointed by President Regan and President Bush, don't differ at all in the fundamental idea that what the federal scheme is intended to do is not to make investment decisions but to require adequate disclosure.

And, indeed, I don't think the plaintiffs really have a quarrel with me about that. They're saying that the disclosure was inadequate, they're unable to describe it I think in this case other than quarreling with the quality of the business venture as it turned out after the fact. But I don't think the bespeaks caution doctrine in any way undermines the securities law policy at all. It simply says that people are not going to be sued and go through discovery anymore if they're given a fair telling of the story.

THE COURT: You're not suggesting, are you, that the bespeaks caution doctrine should be in any way an avenue by which misleading, materially misleading, inadequate disclosures, fraudulent disclosures, failures to disclose critical material facts could be excused simply by some sort of cautionary statement at the tail-end somewhere

or up front for that matter or anywhere else --

MR. POSEN: It is an interesting --

THE COURT: -- so as to immunize that party from responsibility otherwise?

MR. POSEN: There is no immunization available. You can't give yourself a shot, I don't think, your Honor. I mean there is, I suppose, a theoretical extension to the absurd almost of the doctrines in extreme in which there is a tension between those concepts, but "bespeaks caution" as applied in the cases that we've relied on so heavily and as I'm arguing before you today, does not immunize a fraud. But what I -- can I turn to the specifics of the problem as we confront it in the securities industry?

THE COURT: You have also said, have you not, that if the prospectus bespeaks caution, in the sense that you believe the doctrine should be applied, it does not cancel out in effect falsity or misleading omission?

MR. POSEN: Material falsity.

THE COURT: Material, material.

MR. POSEN: That's correct, your Honor. My analysis of --

THE COURT: Should a court, finding in the prospectus the satisfaction of the doctrine for its application if that were so, is it conceptually possible for the court to thereafter consider and find material

misrepresentation? Once the doctrine is found applicable to the prospectus, is that the end of the ballgame there?

MR. POSEN: I think so, your Honor.

THE COURT: I think that's what you suggested, isn't it, yes, the doctrine is?

MR. POSEN: Yes. I mean I think, I think, if I anticipate the concern that you are telegraphing, it is that the second half of that inquiry might somehow be ignored. And I believe fairly applied, the second half of that inquiry has been subsumed by the proper application of part one. And let me turn to the specifics --

THE COURT: And the --

MR. POSEN: No, I guess not.

THE COURT: And the bespeaks caution provisions, those cautionary provisions, do they have to bear any relationship to the particular areas in this case -- the subjects in this case are of alleged misrepresentation, material misrepresentation or nondisclosure -- must there be a relationship of some kind?

MR. POSEN: I suppose in order for them to be fair cautions, there has to be some kind of relation. I would not want to restrict the doctrine or the scope of the cautions too much by its iteration today in a theoretical way in how focused the caution has to be to another issue either stated or not in the prospectus. But it has to be a

fair warning.

THE COURT: All right, fair enough. Let me see if I have to ask any other questions. Yes, go ahead, I think we've cover the parts I want. Go ahead. Excuse me for the interruptions.

MR. POSEN: I'm happy to try to answer them, your Honor.

I have, fueled by the outrage of the attack on my partner's honor, tried come up with a shorthand device to describe my reaction to the plaintiff's assault on his perfect prospectus and I have devised the name of the corollary or inverse to the bespeak caution doctrine and it's called edit to win.

And the plaintiff's brief in this case does simply that very thing. And this editorial process is a direct response to your Honor's last question, which is: Need the cautions fairly relate to the alleged infraction? And the famous sentence which we've written to you about ad nauseam and I repeat again here -- which doesn't show up till page 28. We're usually accused in cases like this of hiding the bad news. This time we've put all the good news all the way on page 28. It said that:

The partnership believes that funds generated from the operation of the Taj Mahal will be sufficient to cover all of its debt service (interest and principle).

That's the gist of it. That's the fraud.

Referring back to the Princeton Doctrine, I think the next sentence in this prospectus ends the inquiry, other circuits notwithstanding. Plain common sense tells you that it is not a fraud if the sentence is followed by the words, English words with meaning:

No assurance can be given, however, that actual operating results will meet the partnership's expectations.

That's the next sentence of the text. It's omitted from the argumentation provided by the plaintiffs.

THE COURT: And you would argue that that demonstrates the clearest kind of direct relationship between the caution and that to which it relates.

MR. POSEN: In a sense, the sentences, one has to follow another, and they did without an interruption. But more, more than that, your Honor, reading this document, and it appears I think both attached to our codefendant's brief and to the affidavit I've submitted as an exhibit -- this is what it actually looks like, your Honor. (Indicating) I don't know if you've had an opportunity to look at this part of the documentation, but this is a sort of statutorily required cover and then there is a summary which is also required by regulation to appear in that order. But the very first thing that appears in this

document after the cover and the summary in the front is not the traditional item, it's not what comes later, the company, it's history, the building, the Taj, our hopes of the future, the financials, what comes next is, we've written it out, "Special Considerations." And you can't see it from here, but you'll see it in the exhibit.

And in italics before you get to the text of the whole book it says before making a decision to purchase any of the bonds, prospective purchasers should consider careful the following factors among others set forth in this prospectus which could materially adversely affect the operations of the partnership and its ability to make necessary payments to the company to meet the debt service requirements of the bonds and the security for the bonds. I won't read you all nine pages that follow. 16 special considerations.

Poor Hiller. He thought they wouldn't be able to sell the bonds. I mean, I imagine, he'd written nine pages of prospectus text of special considerations with that italicized premise which specifically goes to the very issue alleged to have been fraud.

My argument, your Honor, is that the text, more than the cases even, the text governs. There must be, if people are going to be able to issue prospectuses, sell bonds and stock in this society under the regulatory and statutory

framework with which we live, a way that you can accurately write what you mean and not be sued because the bonds declined in value.

I would conclude, other than answering any other questions, your Honor, by referring to the cases. And in that regard, I thought about them, I looked at them last night. I recalled that, and I think your Honor is aware, that we recently had an opportunity to rehearse this argument before Judge Simandle in connection with an argument about the discovery. And I am, in referring to that conversation, fully mindful that the subsequent order is not the law of the case, wasn't intended to be; it was a ruling on discovery and is not in any way binding here. Nonetheless, Judge Simandle's comment in the course of that argument was more pointed and exactly the one that I would like to conclude with. He said at one point in words or substance to the plaintiffs in the course of that argument: I considered these cases very carefully and I've read them and I tried to distinguish them from this case and I couldn't. I think that's a fair representation of Judge Simandle's comment. If it's not, I adopt the words and suggest to you that this case is well within the bounds of those in light of the text itself. These cases ought to be dismissed and ought to be dismissed with prejudice.

THE COURT: And you say we have a clean slate

here in the Third Circuit and you do not believe that there are any existing, therefore, precedents in the Third Circuit that could be inconsistent with or in effect or even discourage the application or adoption of the bespeaks caution doctrine in this circuit.

MR. POSEN: That is a precise and accurate summary of my position, the Herskowitz case on expert opinion notwithstanding.

THE COURT: Okay.

MR. POSEN: Thank you.

THE COURT: Thank you very much.

MR. BASKIN: Good afternoon, your Honor. I'm Stuart Baskin from Shearman and Sterling. I will be very brief since you wanted to confine the argument to this one point and Mr. Posen addressed it so concisely.

I would remind the court that my particular client is here purely as a Second Circuit defendant. Every case in which Merrill Lynch was sued on, we are visitors from the Second Circuit and, indeed, the only allegation in the complaint about Merrill Lynch is that we were the underwriter, we were only sued on the prospectus.

A point worth making, your Honor, on choice of law. I fully agree with Mr. Posen, there is certainly nothing in this circuit that will preclude utilization of the bespeaks caution doctrine. Moreover, with respect to the Second

Circuit transfer cases that are here, as we briefed in our brief, there really are two lines of analysis as to which choice of law to follow. I believe the better line of analysis is that the Second Circuit's case law should provide a strong source of support, close consideration to your Honor. There is, indeed, another line of analysis that says the Second Circuit case law is absolutely preclusive here, and we cite those in our reply brief later on. But I am happy to deal with reality that whether you look at the Second Circuit case law, the First Circuit case law, the Sixth Circuit case law or the Eighth Circuit case law or the Ninth Circuit case law, that 15 circuit court judges of all political stripes agreed that the doctrine of bespeak caution fully conforms with the securities laws and is compatible with the goals and objectives of the securities laws.

Let me address, if I can, some of the questions your Honor raised very briefly, some of the concerns.

It is not a pole; on the one hand bespeaks caution, and on the other hand misstatement. As Mr. Posen said, the question of whether there is a misstatement is subsumed in the question of whether the prospectus contains suitable and appropriate warnings. Because, remember, your Honor, the test for materiality, and it's not new here, your Honor, it's been the case since Northway, the test of

materiality is you have to look at the totality of the disclosures.

In the case of the First Circuit in the Romani case, which we cite, the First Circuit says you don't isolate specific sentences. You don't turn to page 28 of the prospectus and say: Look, we could find a sentence in the prospectus that looks bad and if you delete the sentences that follow and if you delete the nine pages that precede it that sentence is a bad sentence.

THE COURT: Excuse me for interrupting, but are you troubled at all procedurally here, aren't you asking in the bespeaks caution doctrine and its application, aren't you asking the court in effect to assess the adequacy of the disclosures of risk from the face of a complaint with all of the requirements, some of which we've mentioned, that apply to motions for dismissal? Does that suggest that a motion for dismissal may not procedurally be the appropriate vehicle to decide this matter?

MR. BASKIN: Well, I think motions to dismiss, your Honor, is an appropriate vehicle. Let's look at it in two respects. First, in terms of sheer precedent, that is, of course, exactly what the Second and the First and the Sixth Circuit did, they disposed of complaints on motions to dismiss with prejudice, precisely because they said the textual language is what it is, it's not going to get any

better or any worse after discovery. The textual language is what it is in this prospectus. And what the court said was, and I think the test is a meaningful one, the court said, to use the phrase in the First Circuit, we're going to read the cautionary language, we're going to read the risk factors, we're going to take them in their totality, not isolated, we're going to look at them in connection with each other and what we are going to ask is did the disclosure document disclose the risks of the investment in a meaningful way? And if it did, the First Circuit said, the prospectus cannot be challenged as a matter of law.

The Second Circuit adopted a very similar position, your Honor. They said we'll look at the total -- totality of the disclosures and we'll ask ourselves whether the disclosure document sets forth the fundamental nature of the investment.

THE COURT: The principle of most favorable inference doesn't bother you in this process?

MR. POSEN: No, I think again it is subsumed in the process in the sense that you cannot focus -- you do not apply the most favorable inference to a sentence standing alone. What you must look at is in applying that construct, what are the totality of the disclosures? Did they provide a human being who read the prospectus with meaningful disclosure, in the words of the First Circuit,

or with fair disclosure, in the words of the Second?

THE COURT: Okay. What if this court permitted the plaintiffs to amend? I ask you to assume that, assume that this court permitted the plaintiffs to amend their complaint so as to add the Laventhol report, would that complaint so supplemented and amended still be subject to dismissal?

MR. POSEN: I believe, your Honor, it would be impossible to amend it with that or anything else, and let me explain why. Let's first take the generality and then we can get to the Laventhol report specifically. And the generality is that the prospectus says what it says. If the Laventhol report was bearish on the Taj, and frankly let's put that to the side, if it was bearish on the Taj and the complaint were amended to reflect that, what the Laventhol report would mean in saying it was bearish on the Taj was that the combination of factors, growth in the marketplace of Atlantic City, the likelihood of the Taj achieving a fair share of that market -- of that growth in the marketplace, the likelihood of Mr. Posen's clients running this casino in an efficient way, all of those factors would lead to Laventhol's conclusion. But the point, your Honor, is that all of those factors are highlighted in the prospectus. The prospectus warns in the clearest of language so that no one could avoid it, the

prospectus warns this is an initial public offering, there is no casino here yet to judge, we have no history running a -- we have no history running a casino of this size. No one has, the prospectus says. You've got to bear the possibility, the prospectus says in nouns and verbs, that if the construction project comes up late, that will have a material impact on debt service. The prospectus says again in nouns and verbs that regulatory considerations or our failure to achieve a fair market share, all of those would have a material impact on our ability to service the debt.

So, in a generality, your Honor, the reason why the First and the Second and the Sixth circuits have all said that once you conclude that there is meaningful disclosure or once you conclude there is fair disclosure about the nature of the investment, that the proper relief is dismissal with prejudice and not right to replead.

The reality is if any prospectus ever alerted investors to what they were buying and the risks that might occur, this is it.

Now, to take it further, to look at the Laventhol report specifically as opposed to it generally, the Laventhol report, your Honor, as we pointed out, was not a report generated by the issuer, it was a public record document, just as many, many other annalists' reports were out there that were public record documents. And the case

law, which they never dispute, we cite in our opening brief and they never take issue with, the case law is as a matter of law such public record information is not discloseable in any event. Moreover, the Laventhol report on its face says it should not be used for the very purpose for which they want to use it. So the report in its specifics would not advance the analysis here at all. But, more importantly, the general principle remains the same, your Honor, as the First, Second and the Sixth Circuits made clear in motions to dismiss and the Eighth and the Ninth in summary judgment motions, but all the same because they all looked to the text of the document, regardless when they analyzed it, they only looked to the text of the document, all those cases, and what they all said was no person who read that document could fairly conclude that he was buying other than a very risky piece of paper here. And as long as the risk is highlighted in a fair way and in a meaningful way, that's all you can expect from prospectus writers like Mr. Posen's partner.

And, again, unless the goal is to say that every piece of paper that gets issued in the capital markets will be subject to challenge three, four years later and someone can weave his way through a prospectus, skip over the capitalized and italicized warnings and go to a specific sentence in the middle of -- buried in the middle of the

prospectus which has warnings that immediately follow it which they also delete, unless the goal is to go through this sort of exercise in every single case where an investment turned sour, then I submit to the court that the unanimous decision of those 15 judges makes ample sense both as a matter of law and as a matter of public policy. And that there is nothing they could amend, nothing they could say, nothing they will do which would change the language of the prospectus and the care and cautions with which this prospectus was written.

THE COURT: You also don't feel that under any circumstances here that this court should permit more latitude, permit the court's consideration of the materials extrinsic to the current record that the plaintiffs might urge upon the court and convert this to a summary judgment motion of any kind? You don't think that's necessary?

MR. BASKIN: No, no, I do not believe that's necessary. I believe that --

THE COURT: Or appropriate?

MR. BASKIN: I would not urge that course because I believe procedurally that this extrinsic data is legally irrelevant. I believe, moreover, as a practical matter you end up the same place both ways, your Honor. I think whether you did that or whether you looked at the text of the document under the canon of 12(b)(6) we'll be in the

same place.

THE COURT: Okay, that inspired my first questions.

Okay, thank you very much.

MR. POSEN: Thank you.

THE COURT: Everybody agree? Go ahead.

MR. FEFFER: Thank you, your Honor. Joel Feffer from Wechsler Skirnick. Mr. Wechsler apologizes for not being here as the Second Circuit has on short notice scheduled an argument. Today we moved to adjourn it on consent and we lost. So...

THE COURT: Okay.

MR. FEFFER: I feel somewhat inadequate after these two brilliant presentations because I'm not certain in my mind what the bespeaks caution doctrine is. I know that a number of courts have used the phrase in certain contexts and I have great difficulty separating the phrase from the context in which it was used. And it brings to mind a statement by Judge Friendly in Denny against Barber, Second Circuit decision in 1978 which is cited to great extent usually by defendants. In dealing with a motion, an appeal from a motion directed to the pleadings, Judge Friendly noted as follows:

We see no profit in attempting to analyze these decisions which may or may not be consistent and each of

which necessarily rests on its particular facts.

I think what the defendants are doing here or what they're attempting to do is they're taking a phrase that appears in certain decisions and they're converting it in effect to a caveat emptor in this case. They are saying -- we're talking -- this is primarily a prospectus case. The '33 act, Sections 11, Sections 12 of the '33 act have very few elements. Primarily, at least at the pleading stage, primarily a material representation and damages. They are saying, as I understand it, that if a prospectus is couched in cautionary terms -- that clearly was, I don't think there is any doubts about that -- then in effect nothing in that prospectus could be material as a matter of law.

Now, my predilection is I'm fairly conservative, at least in an 18th Century sense of the word, and I'm not sure I have a problem with caveat emptor, but it's definitely not the law in this instance. In fact, there is -- there are situations, and they're very common, in fact most capital is raised in private placements where there is no required disclosure whatsoever, the purchases are made by accredited investors. There you have a true caveat emptor situation, not in a public offering here.

We are not -- the plaintiffs are not alleging that this document described these bonds in anything other than terms of speculative securities. I mean, this is a clear

junk bond prospectus. That's not the issue here. The issue, however, or the claim, really, is plaintiffs were willing to assume or purchasers of this are willing to assume the business risks. What they are not willing to assume is the risk that there is a material misrepresentation in the prospectus. And I just don't -- I think "bespeaks caution" is really a slogan that is used in an attempt to avoid the issue. The issue is whether there is a material misrepresentation.

The defendants make much of the fact that a good deal, although not all, of our case is based on one itty bitty sentence on page 28 of the prospectus. Well, that one itty bitty sentence appears in the midst of a section entitled Management's Discussion and Analysis of Financial Condition and Results of Operation, which is usually in the business referred to as the M, D and A section. The M, D and A section happens to be the center piece of the SEC's disclosure requirements. The purpose of it is to allow the shareholder or prospective investor to view the company through the eyes of management. And there are two -- I mean, it's clearly material. Prospective purchasers of the debenture or a bond or any other debt instrument could think of nothing more material than whether he's going to get his principal or interest back.

And I might add on top of that if that sentence was

not in the M, D and A, this prospectus or the registration statement which encompasses this prospectus would never have been declared effective by the SEC. It's required to be stated there. According to plaintiffs there was no reasonable basis for making that statement. I understand that and our clients understand that they did not guarantee that there would be sufficient cash flow. We aren't asking for guarantees. Our contention simply is that there was no basis whatsoever for making that projection that there would be or believe that there would be sufficient cash flow. I think if the defendants are correct in their interpretation of the "bespeaks caution" cases that you would have -- you could take a prospectus of this size, this is single, you know, not two-sided copy, and you could really reduce it to the size of a laundry receipt and just put on it: You purchase this stock, you purchase these bonds, you're taking a great risk and you may lose all your money. There would be no reason to print -- there would be no reason for these extensive disclosures which are specifically required by the SEC.

I just want to focus on just -- I don't want to take up too much time because it appears to me at the very least that you have a much better grip on the issues than I do. I want to discuss the Pincus against Oppenheimer case from the Second Circuit just to point out that I just don't

think you could separate a doctrine from the cases or phrase from the cases in which they arise.

The Pincus case involved a prospectus for a closed end mutual fund. In one place in the prospectus the following two sentences appear: The shares of closed-end investment companies frequently trade at discount from or premium to their net asset values. The shares are also expected to trade at a discount or premium.

Well, in that, that was the sole basis for alleged liability in Pincus. It was probably an unfortunate choice of -- just probably unfortunate phrasing because as everybody is aware, that shares of closed-end mutual funds usually trade at a discount to net asset value.

Nevertheless, right after that sentence there was a cross-reference to another section of the same prospectus where the following appears:

Shares of closed end investment companies frequently trade at a discount from net asset value but in some cases trade at a premium.

That is, of course, an absolutely accurate statement of this. The defendants claim that Pincus is particularly apposite to this case. If that's true, I would think that the defendants should then point to some section of this prospectus following their statement that they believed there would be sufficient cash flow to cover debt service

where they also say that they had no reasonable basis for such belief. Obviously, if that statement appeared in the prospectus, none of the bonds would have been sold.

If the court does not adopt their in effect equation of the doctrine of "bespeaks caution" with caveat emptor, then you really have to deal with the basic issue: Are the misrepresentations we allege material? And that is an issue that the Supreme Court in TSC against Northway has said is very, very difficult to resolve on I believe summary judgment in that case and a fortiori motion to dismiss. I think the complaint is perfectly adequate as it now stands. I think we could add to it, but I don't particularly see any point because I think you normally, you know, wait until you finish discovery and then cover whatever problems there are in the complaint in the pretrial order.

And I don't really have anything else to say that will not take up any more of your time. I would be happy to answer any questions you might have.

THE COURT: I don't think I have any. Thank you very much.

MR. FEFFER: Thank you.

THE COURT: Thank you.

All right, thank you, counsel. This has been very helpful. You will not be meeting with Judge Simandle this

afternoon. I am going to continue the stay in this case until the rendition of the opinion of the court and order deciding this motion to dismiss.

So, you and Judge Simandle are relieved of meeting this afternoon. We hope to get back to you soon. Thank you very much.

(Proceeding then ended)

C E R T I F I C A T E

I, THEODORE M. FORMAROLI, Official Court Reporter for the United States District Court for the District of New Jersey, Certified Shorthand Reporter and Notary Public of the State of New Jersey, do hereby certify that the foregoing is a true and accurate transcription of my original stenographic notes to the best of my ability of the matter hereinbefore set forth.

Theodore M. Formaroli
Official U. S. Reporter
N. J. Certificate No. XI433

DATE: July 14, 1992